Comments for the July 1, 2009 Stakeholder Meeting of the Economic and Allocation Advisory Committee[1]

Submitted by Ken Johnson (unaffiliated)

The Economic and Allocation Advisory Committee's advice and recommendations to ARB on AB 32 implementation should address the following two questions:

(1) Does free allocation of allowances have any advantage over free allocation of the allowance cash value (from auction revenue)?

(2) Should a portion of the allocation (of either allowances or auction revenue) be applied to achieve further emission reductions pursuant to the maximum-reduction requirement of AB 32, Sec. 38560?

As noted in Judi Greenwald's presentation, "Distributing allowances is like handing out money …". Whether a regulated firm receives free allowances, or buys all of its allowances at auction and gets the cash equivalent of is allocation from auction revenue, it will incur the same regulatory costs. But there are advantages to cash allocation. First, price discovery and market liquidity would be facilitated by requiring all regulated firms to fully participate in the auction, including those that are entitled to free allocation. Second, a price floor could be more easily implemented with a full auction.

If most allowances are freely allocated, then a price floor could significantly deplete the auction pool and diminish market liquidity. But if cash allocation is employed with 100% auctioning, then each firm's allowance share can be determined as a fixed percentage of auction revenue (rather than a fixed number of allowances). This would ensure that there will always be sufficient revenue to cover free allocations, even if the number of issued allowances is significantly limited by the price floor.

The Waxman-Markey bill sets a new precedent in establishing a price floor of $10/ton in 2012, increasing at a 5% real annual rate thereafter. AB 32 also has statutory support for a price floor in Sec. 38560, which requires "the maximum technologically feasible and cost-effective greenhouse gas emission reductions …". A price floor would incentivize maximum emission reductions within a cost-effectiveness limit (i.e., a maximum "cost per unit of reduced emissions …," Sec. 38505(d)) defined by the price threshold.

A price floor can be implemented as a reservation price, as in Waxman-Markey, or as a buy-back of allowances. As noted in the MAC report[2] (page 68), "CARB could enforce a floor by *purchasing* allowances and removing them from circulation whenever the allowance price reached the lower limit." Alternatively, auction revenue or allowance allocation can be used to directly induce or incentivize emission reductions beyond the

[1] http://www.climatechange.ca.gov/eaac/index.html

[2] http://climatechange.ca.gov/market_advisory_committee/index.html

cap limit. This use is recognized in the CEC/CPUC report[3], which states the following (page 137): "In evaluating allocation options, we consider the extent to which they provide incentives that will further the reduction of GHG emissions in California." Here also, Waxman-Markey establishes a new precedent by establishing a five percent allowance set-aside to support tropical forest conservation. This support would not come from offsets; it would result in emission reductions beyond the cap limit.

Judi Greenwald's presentation notes that allowance value "Can be in the form of allowances themselves, or revenues from the sale of allowances at an auction;" and the presentation asserts that the allowance distribution "Does not affect the overall environmental result (the emission reductions achieved by the program)". On the contrary, the allowance distribution (or revenue distribution) can affect the overall environmental result if it is used for that purpose, and Sec. 38560 provides statutory support for such use.

One particular policy option that should be considered by the EAAC is the use of allowance set-asides to support voluntary renewables. For example, the Berkeley FIRST program, which provides financing for residential solar installations[4], would not achieve and could not claim environmental benefits unless the surplus emission allowances resulting from the program are captured and retired. An allowance set-aside for Berkeley FIRST would be compatible with Sec. 38560 because it would not increase industry's costs or regulatory burden; it would only ensure that the program participants' investment in solar energy results in additional emission reductions, and does not simply reduce industry's costs without providing any environmental benefit. (Federal cap-and-trade legislation could include similar set-aside provisions to avoid nullifying the environmental benefits of state and local GHG-reduction actions such as California's AB 32 regulations.[5])

Environmental Justice advocates recently filed a lawsuit against ARB, challenging the legality of the Scoping Plan under AB 32, and alleging specifically that the plan "fails to achieve the maximum technologically feasible and cost-effective reductions."[6] It is important that the EAAC understand and clearly address the maximum-reduction requirement to ensure that its advice and recommendations to ARB are legally defensible.

Sec. 38560 imposes the following requirements: (1) ARB's regulations must be feasible and cost-effective, and (2) subject to these conditions, emission reductions are to be maximized. In this context, "cost-effective" connotes a threshold condition subject to

---

[3] Publication # CEC-100-2008-007-F, October 16, 2008
http://www.energy.ca.gov/ghg_emissions/

[4] "Cities go big with solar financing," by Sara Stroud, May 4, 2009, in *Sustainable Industries*
http://www.sustainableindustries.com/breakingnews/44082122.html

[5] "Preserving Additionality of Complementary GHG-Reduction Actions under Waxman-Markey"
http://ssrn.com/abstract=1421947

[6] http://www.ejmatters.org/media.html

which emission reductions are to be maximized; and in view of Sec. 38505(d) it is clear that the cost-effectiveness threshold is intended to be quantified as a "cost per unit of reduced emissions of greenhouse gases adjusted for its global warming potential" (i.e. dollars per ton CO2-equivalent).

Irrespective of what standards or criteria ARB applies to establish the cost-effectiveness threshold, it is clear that the qualifier "maximum" in Sec. 38560 is intended to influence the choice of policy instruments and the emission reductions that would be achieved, or might potentially be achieved, under AB 32. Neither the "statewide greenhouse emissions limit" in 2020, which ARB has established to be 427 MMT, nor the 422 MMT target established in the Scoping Plan, is determined or influenced by the maximum-reduction requirement. Thus, mere attainment of either the 427 MMT limit or the 422 MMT target would not be sufficient to give effect to the maximum-reduction requirement. But the allocation of allowances or auction revenue could provide one mechanism for achieving emission reductions beyond the 422 MMT target in the event that such further reductions would be feasible and cost-effective according to Sec. 38560.